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No. 82-1980
IN THE

Supreme Court of the United States

October Term, 1982

HELEN SMITH,

Petitioner,

vs.

FRED H. HARMSEN, *et al.*,

Respondents.

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT.

JENNINGS, ENGSTRAND & HENRIKSON,
PAUL D. ENGSTRAND,
GEORGE J. BERGER,
HORVITZ & GREINES,
ELLIS J. HORVITZ,
ALAN G. MARTIN,
FREDERIC D. COHEN,
16000 Ventura Boulevard,
Suite 401,
Encino, Calif. 91436,
(213) 995-0800,
Attorneys for Petitioner.

Parker & Son, Inc., Law Printers, Los Angeles. Phone 724-6622

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Introduction.

That the issues presented by Helen Smith's Petition for Writ of Certiorari require review is, we submit, clear without need of further argument. However, we take this occasion to present, consistent with Rule 22.5 of this Court's rules, a limited reply to Respondents' exceptionally inaccurate and ill-founded opposition to the petition, specifically regarding the mistaken suggestion that this Court should simply ignore the fundamental issues of federal securities law raised by this case.[1]

[1]Under the constraints of Rule 22.5 we do not address the utter falsity of Respondents' depiction of the record, as we had occasion to do in the briefs before the Court of Appeals, except to note that even Respondents' blatant distortions of fact (1) do not involve United States National Bank ("USNB"), let alone its shareholders, and (2) have nothing to do with any securities transaction. It is worth repeating that, to the extent Helen had any dealings with USNB, they were all reviewed and approved by the FDIC, USNB's receiver.

(footnote continued on following page)

The Critically Important Federal Securities Issues Raised by the Petition Are Necessarily Dispositive of the Case Against Petitioner.

In the absence of a definitive analysis by this Court of the viability of secondary liability under the federal securities laws, Respondents were able to present this case to the jury as an undifferentiated mass in which their federal securities law theories ("aiding and abetting," "conspiracy," "control person") were used interchangeably with each other and with the pendent state law claims. ("Whatever you want to call it, aiding and abetting, conspiracy, controlling person. When it all comes down to it, it's the acts of all of them that led to those . . . people losing [their] . . . investment. . . ." [RT 6608].)[2]

In accordance with the above rule, we also do not discuss here the relevance of this Court's recent decision in *Dirks v. Securities and Exchange Commission*, ___ U.S. ___, 51 U.S.L.W. 5123 (July 1, 1983), which lends additional support to one of the principal contentions raised in Helen Smith's Petition for Writ of Certiorari, namely that there can be no secondary liability for aiding and abetting under the securities laws unless the requisite elements of a primary cause of action under § 10(b) and Rule 10b-5 have been met. Because *Dirks* is directly relevant, however, we are concurrently filing, in accordance with Rule 22.6 of this Court's rules, a supplemental brief which analyses the immediate import of that decision.

[2]Respondents' muddled approach to this case is illustrated by their persistent and fallacious equating of injury to the Bank (a derivative theory based upon a cause of action available, if at all, only to the FDIC as the Bank's receiver) with direct injury to the Bank's shareholders and this, in turn, with securities fraud. (Opposition at p. 14.) Similarly, Respondents dismiss as inconsequential the fact that it was demonstrated without controversy not after but *before* trial that all the named plaintiffs

Thus, starting with the premise that a viable federal cause of action exists for secondary violations of federal securities law, Respondents were able to present the jury with a maze of undefined accusations representing an indeterminable admixture of federal and state causes of action packaged together under a "whatever you want to call it" theory of liability.[3] Now, however, Respondents disingenuously suggest that their state law claims against Helen Smith are somehow independently viable regardless of the lack of merit of the federal securities claims employed indiscriminately against Helen, regardless of the absence of fundamental federal subject matter jurisdiction, and regardless of the basic denial of due process resulting from numerous procedural irregularities, including the lack of any properly identified class. In Respondents' view this is somehow an inappropriate context for the Court's consideration of the very important issues on which the case always turned. (Opposition at p. 13.)[4]

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acquired their stock before the earliest alleged wrongdoing of any kind by Helen and therefore there was no plaintiff who had standing to sue her on *any* count. Accordingly, the jury necessarily fixed Helen's liability in the abstract, *i.e.*, in the absence of any person purporting to have a cause of action against her. (Opposition at p. 17.) The Court of Appeals opinion itself reflects a similar confusion of terminology and theories, ostensibly deciding the case solely on an aiding and abetting theory (Petition, App. at 18), yet relying on principles imported from the common law of conspiracy to support that decision. (Petition at p. 19.)

[3]Cf. *Michigan v. Long*, ___ U.S. ___ 51 U.S.L.W. 5231, 5233-5234 (July 6, 1983), where the Court recently stated, in deciding whether to review a state court decision, that it will not deem state grounds "independent" where they are loosely interwoven with governing federal law.

[4]Similarly, Respondents suggest that the "controlling person" aspect of the "whatever you want to call it" theory of liability premised on section 20(a) of the Securities Exchange Act is somehow different and stands apart from the aiding and abetting theory relied upon by the Court of Appeals. (Opposition at p. 13.) It was, however, for good reason the Court of Appeals eschewed consideration of Section 20(a) in its

Plainly Respondents seek to obscure what Petitioner has repeatedly urged: whether it is phrased in terms of "aiding and abetting," "control person" or "conspiracy", liability under § 10(b) cannot be imposed where, as here, there is no duty to disclose, no intent to deceive, and no causal connection between the non-disclosure and any damage to the plaintiff; these requirements cannot be evaded or diluted by any sleight-of-hand, much less simply by switching labels for the theory of liability. (See Petition at pp. 11-18.) Respondents are understandably reluctant to confront these basic principles. Absent a valid basis for proceeding against Petitioner under the federal securities laws, the District Court could not have asserted pendent jurisdiction over any state law claims. E.g. *Tully v. Mott Supermarkets, Inc.*, 540 F.2d 187, 195-196 (3d Cir. 1976). See *Ayala v. United States*, 550 F.2d 1196, 1198-1201 and fn. 8 (9th Cir. 1977), *cert. dismissed* 435 U.S. 982 (1978) [absent an independent ground of federal jurisdiction over a party, "pendent party" jurisdiction cannot be asserted to hear state law claims against that party]; see also *Aldinger v. Howard*, 427 U.S. 1, 14-15 (1976). Even the Ninth Circuit's decision in this case recognizes the need for "an independent federal jurisdictional basis for the court to consider the pendent state claims. . . ." (Petition, App. at p. 12.) In short, the validity of the Court of Appeals' aider and abettor theory of liability is entirely dispositive of the action before this Court.

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opinion. Having used "controlling person" interchangeably with aiding and abetting, conspiracy, and other claims at trial, Respondents could suggest on appeal only Petitioner's marital relationship with C. Arnholt Smith as a basis for "controlling person" liability. This, of course, is in plain violation of this Court's repeated articulation of the prerequisites to § 10(b) liability and would make *any* purely personal relation with a securities law violator a basis for secondary liability. (See Petition at pp. 11-12.)

The substantive weakness of the aiding and abetting theory is of course compounded by the fundamental procedural defects in the proceedings, prominently including the class certification issue, which infected all of the claims against Helen. Thus, none of the named plaintiffs traded the Bank's stock contemporaneously with any alleged misconduct by Petitioner and none had any individual claim against her. No proper class or subclass was ever identified for purposes of § 10(b), the only federal basis for any action against Petitioner, and indeed, no class was ever framed in terms of any purported cause of action against her. The action as a whole lacked even the rudiments of procedural due process as regards Petitioner. As it was, she faced multi-million dollar liability without knowing the identity of or being able to confront even one of her phantom adversaries, and without knowing what it was she was supposed to defend against.

The unprecedented morass of ill-defined and misused terminology and accusations used by Respondents to ensnare Petitioner cannot divert attention from the pivotal importance of the aider and abetter theory of liability in this case. Federal courts are primarily forums for the resolution of federal claims, not state claims, and the question whether federal jurisdiction exists is therefore hardly a matter of secondary importance. Moreover, if the question whether aiding and abetting liability is permissible under § 10(b) and Rule 10b-5 is not dispositive here, it is hard to imagine a case where it ever would be. With the doors of the federal courts thrown wide open to the assertion of any and all claims for "secondary liability" under the federal securities laws, federal courts become the preferred forum for litigating pendent state claims as well, and plaintiffs will always be in a position to assert, as Respondents did at trial, that such a mass of allegations warrants the imposition of liability under some theory "whatever you want to call it"

under federal or state law. The key issue — the viability and requisites of the federal claim — would become only a nominal and utterly dispensable consideration, just as standing does under the Court of Appeals' decision. In this case, these issues were fully preserved and for the first time squarely (if erroneously) addressed by the Court of Appeals. For these reasons, this case is precisely *the* most appropriate vehicle in which to consider and reject the Court of Appeals' explicit determination of critical federal securities law issues necessary to its decision.

Conclusion.

For the reasons set forth in the petition, Petitioner's supplemental brief, and the instant reply brief, Petitioner respectfully prays that the Court grant review in order to resolve the important and dispositive securities law and due process issues which the Court of Appeals' decision has raised.

Respectfully submitted,

JENNINGS, ENGSTRAND & HENRIKSON,
PAUL D. ENGSTRAND,
GEORGE J. BERGER,
HORVITZ & GREINES,
ELLIS J. HORVITZ,
ALAN G. MARTIN,
FREDERIC D. COHEN,
Attorneys for Petitioner.